

STATE OF HAWAII  
DEPARTMENT OF LAND AND NATURAL RESOURCES  
Land Division  
Honolulu, Hawaii 96813

September 26, 2008

Board of Land and Natural Resources  
State of Hawaii  
Honolulu, Hawaii

PSF 03HD-153  
Hawaii

Termination of Kona Kai Ola Development Agreement with  
Jacoby Development, Inc. for public lands at Kealakehe,  
North Kona, Island of Hawaii, Hawaii. Tax Map Keys: (3) 7-4-  
08: 71, 999, and portion of 3.

REQUEST:

Accept and Ratify Jacoby Development, Inc.'s ("JDI") Election to  
Terminate the Kona Kai Ola Development Agreement dated  
November 18, 2005 between the State of Hawaii (through the Board  
of Land and Natural Resources or "Board") and JDI.

APPLICANT:

Department of Land and Natural Resources ("DLNR")

SUBJECT PROPERTY:

Approximately 300 acres of public lands situated at Kealakehe,  
North Kona, Island of Hawaii, identified by TMKs (3) 7-4-08:71,  
999, and portion of 03 ("Subject Property"). The Subject  
Property is located adjacent to the existing Honokohau Small Boat  
Harbor. (see **Exhibit A**)

BRIEF SUMMARY:

By letter to Chairperson, Laura Thielen dated June 27, 2008, JDI  
notified DLNR of its decision to terminate the Kona Kai Ola  
Development Agreement effective July 1, 2007 pursuant to Sections  
12(a) and 12(c) of the Development Agreement. (see **Exhibit B**)

In its letter, JDI also alleged that DLNR failed to perform its  
obligations under the Development Agreement, which DLNR has  
denied in its letter to JDI dated August 4, 2008. (see **Exhibit C**)

OVERVIEW OF THE DEVELOPMENT AGREEMENT:

On April 25, 2003, as Agenda Item D-14, the Board approved the  
issuance of a Request for Qualifications / Request for Proposals  
("RFQ/RFP") to solicit potential developers to develop the  
Subject Property. On January 23, 2004, DLNR issued the RFQ/RFP,

which resulted in the selection of JDI. On November 18, 2005, the State of Hawaii (through the Board) and JDI entered into the Kona Kai Ola Development Agreement (the "Agreement").

The Agreement contemplates JDI's development of a 500-acre master-planned project (known as "Kona Kai Ola") on the Subject Property and a 200-acre adjacent parcel owned by the Department of Hawaiian Home Lands ("DHHL") under ground leases from the two agencies for their respective properties.<sup>1</sup>

In general, the Agreement provides a process under which JDI is to seek the Board's approval of master plans for the project, allows JDI to perform necessary predevelopment activities such as investigating the Subject Property and obtaining all government permits, approvals and entitlements required to develop the project, and provides various terms and conditions that JDI must fulfill before it will be issued a 65-year ground lease for the Subject Property.

Among the conditions that JDI must fulfill before issuance of the 65-year ground lease, are: (a) prepare and submit to the Board a Master Development Plan (providing details of JDI's proposed development of the Kona Kai Ola project, including the proposed uses, construction phasing and timelines, cost estimates, etc) and obtain the Board's approval of the Master Development Plan; (b) prepare and submit to the Board a Core Infrastructure Plan (describing the major infrastructure to be constructed by JDI) and obtain the Board's approval of the Core Infrastructure Plan; (c) prepare and process any and all required EIS for JDI's proposed project and submit the same to the Board in connection with its review of the Master Development Plan; (d) obtain all land use entitlements and discretionary government approvals required to develop JDI's proposed project; and (e) provide satisfactory evidence of JDI's commitment to and ability to complete the construction and installation of the core infrastructure as set forth in the Core Infrastructure Plan.

The Agreement also requires JDI to pay a development fee of \$101,500.00 per year to the State in quarterly installments, commencing January 1, 2007.

Finally, the Agreement provides both JDI and the Board with certain rights to terminate the Agreement. For example, subject to notice and cure requirements, the Board may terminate the Agreement if JDI defaults on its obligations under the Agreement. In addition, Section 12 of the Agreement allows JDI to terminate the Agreement for certain reasons, including but not limited to, JDI's inability to obtain the necessary federal, State and county land use entitlements/approvals, or the imposition by any such government entities of onerous requirements or conditions on JDI's receipt of the necessary land

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<sup>1</sup> JDI has already entered a separate 65-year ground lease with DHHL for the 200-acre DHHL parcel (the "DHHL Lease"). The effective date of the lease is January 1, 2004.

use entitlements/approvals. The full text of Section 12 is attached as **Exhibit D**.

CURRENT STATUS:

1. Master Development Plan, Master CC&Rs, and Core Infrastructure Plan (collectively referred to as the "Deliverables"):

At the time the Agreement was entered, the parties understood that JDI needed to conduct additional studies and perform additional work before it could provide the Board with master plans for the Kona Kai Ola project. Consequently, the Agreement required JDI to submit the above-mentioned Deliverables for review and approval by the Board.

The Agreement sets forth the process under which JDI is to provide the Deliverables for the Board to review. The Agreement provides specific time frames for the Board or its Chairperson to make objections to the Deliverables. The Agreement also provides specific time frames for JDI to respond to any such objections and resubmit revised Deliverables for further review by the Board. The Agreement provides JDI with two opportunities to revise and resubmit the Deliverables. If the Board does not approve the Deliverables after the second resubmittal, the Agreement terminates.

On November 17, 2006, JDI submitted its initial versions of the Deliverables. On April 20, 2007, DLNR provided written comments and objections to the Deliverables.

On August 19, 2007, JDI resubmitted revised Deliverables, including the attached Modified Master Development Plan, which provides for a 400-slip marina, together with commercial, hotel, time-share, park, and community components. (see **Exhibit E**). On October 19, 2007, DLNR responded with written comments and objections to the revised Deliverables.

DLNR agreed to extend the deadline to April 25, 2008 for JDI to resubmit revised Deliverables, but JDI did not resubmit revised Deliverables by that date.

2. Due Diligence and Land Use Entitlements:

The RFQ/RFP noted the lack of entitlements for the Subject Property and that any master planned marina development project would involve extensive efforts to obtain all of the necessary entitlements. Accordingly, the RFQ/RFP expressly disclosed the requirement that the selected developer shall, at its cost, obtain all land use entitlements and government permits/approvals necessary to construct the developer's master plan. Section 9 of the Agreement restated the requirement, and specifically named approvals from the U.S. Army Corps of Engineers, the State of Hawaii, and the County of Hawaii (including general plan, zoning,

and SMA approvals), as well as the requirement that JDI process all required environmental assessments and impact statements.

Upon execution of the Agreement, JDI conducted various studies and due diligence activities. In addition, JDI prepared and processed an environmental impact statement ("EIS") for the entire 500-acre proposed Kona Kai Ola project (which encompassed both the Subject Property and the adjacent 200-acre DHHL parcel) in accordance with the requirements of Chapter 343, Hawaii Revised Statutes. On August 21, 2007, DHHL accepted the final EIS.<sup>2</sup>

JDI also lobbied for a County of Hawaii General Plan ("GP") amendment to allow development of the Kona Kai Ola project. The GP was amended in December 2006, but the County of Hawaii Planning Department has indicated that the current GP designation would not allow the complete development of the current Kona Kai Ola master plan without a further amendment to the GP.

JDI also learned that the application process for a U.S. Army Corps of Engineers ("COE") permit to dredge JDI's proposed marina would require a full NEPA EIS that must evaluate the impacts and mitigation measures for the entire Kona Kai Ola project, including all the land based components, i.e., a NEPA EIS that evaluated only the impacts and mitigation measures for the proposed marina would not be acceptable to the COE. JDI has indicated this NEPA EIS requirement contributed to its decision to terminate the Agreement.

Except for the acceptance of the Chapter 343 EIS and the GP amendment described above, no new entitlements were obtained during the term of the Agreement. As stated in its letter, JDI elected to terminate the Agreement pursuant to Sections 12(a) and 12(c) of the Agreement. These provisions allow JDI to terminate the Agreement due to JDI's inability to obtain the necessary land use entitlements/approvals or the imposition by any such government entities of onerous requirements or conditions on the JDI's receipt of the necessary land use entitlements/approvals.

3. Development Fees (Agreement §5):

Section 5.1(b) requires JDI to pay to the State an annual development fee of \$101,500.00. The fee is to be paid in quarterly installments of \$25,375.00 on January 1, April 1, July 1 and October 1 of each year, commencing January 1, 2007.

Development fees still owed to the State by JDI up to July 1, 2008 (the effective date of JDI's termination of the Agreement) total \$50,800.00, plus late fees totaling \$350.00.

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<sup>2</sup> DHHL served as the accepting agency for the EIS.

4. DHHL Lease:<sup>1</sup>

According to DHHL, JDI is currently past due on lease rent payments totaling approximately \$358,500 under its lease with DHHL for the 200 acres located adjacent to the Subject Property. JDI has requested that DHHL forgive a portion of the rent, which request is pending.

RECOMMENDATION:

That the Board accept and ratify Jacoby Development, Inc.'s ("JDI") election to terminate the Kona Kai Ola Development Agreement pursuant to Sections 12(a) and (c) of the Agreement, subject to the following:

1. JDI's termination shall be subject to the terms and conditions of the Agreement, including but not limited to, Section 12 of the Agreement which provides in part that JDI shall not be entitled to any compensation or other payment whatsoever by the State of Hawaii on account of its termination of the Agreement;

2. This action by the Board shall not constitute a waiver of any rights of the State or the Board under the Agreement, including but not limited to, the right to seek payment of any fees or other sums owed by JDI to the State;

3. The Board authorizes the Chairperson to negotiate with JDI any and all post-termination matters, including but not limited to the payment of any fees owed under the Agreement; and

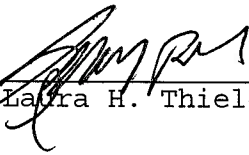
4. The termination of the Agreement shall not revoke the Board's prior approval of April 25, 2003 (Agenda Item D-14), which authorized the issuance of a RFQ/RFP for the Subject Property.

Respectfully Submitted,



Keith Chun  
Planning and Development Manager

APPROVED FOR SUBMITTAL:



Laura H. Thielen, Chairperson





MCCORRISTON MILLER MUKAI MACKINNON LLP

ATTORNEYS AT LAW

CONFIDENTIAL

June 27, 2008

E-MAIL AND REGULAR MAIL

Ms. Laura H. Thielen  
Chairperson  
Department of Land and Natural Resources  
P. O. Box 621  
Honolulu, Hawai'i 96809

Re: Development Agreement dated November 18, 2005  
Kealakehe, North Kona, Island of Hawai'i  
Tax Map Key Numbers: (3) 7-4-08: 003 (por) and 071

Dear Ms. Thielen:

This office represents Jacoby Development, Inc. (**JDI**), the current holder of that certain Development Agreement dated as of November 18, 2005, covering the above-referenced real property. We acknowledge on behalf of JDI receipt of your letters dated April 21, 2008 (the "**April 21 Letter**"), May 16, 2008 (the "**May 16 Letter**") and June 12, 2008 (the "**June 12 Letter**").

Please be advised that while JDI did not respond by April 25, 2008 to DLNR's comments and objections to the Modified Master Development Plan (MMDP), Modified Core Infrastructure Plan (MCIP), and Modified Master Covenants, Conditions and Restrictions (MMCC&R) submitted by JDI and DLNR's demand for payment of allegedly delinquent development fees, JDI disagrees with the assertion that it has breached its contractual obligations under Sections 2.2, 3.2 and 4.2 of the Development Agreement. As set forth below JDI believes that it is DLNR that has failed to honor its obligations and commitments under the Development Agreement and thus contributed to, if not prevented, JDI being unable to adequately and appropriately respond to the comments and objections received from DLNR by that date.

As a result of your April 21 letter and other discussions between JDI and the Department of Land and Natural Resources of the State of Hawaii (**DLNR**) which have occurred over the last several months, JDI has still not received any assurance of assistance from DLNR and/or the State of Hawaii in addressing and resolving certain major issues with the State Division of Boating and Ocean Recreation (**DOBOR**), the County of Hawaii, and the Army Corps of Engineers relating to the required marina improvements under the Development Agreement, the County of Hawaii zoning, permits and approvals necessary for the contemplated development, and the Army Corps of Engineers approvals for certain of the contemplated marina

Ms. Laura H. Thielen, Chairperson  
Department of Land and Natural Resources, Land Division  
June 27, 2008  
Page 2

improvements. At the meeting with you and other representatives of DLNR held on December 13, 2007, you were advised of the serious nature of these issues and the need for more affirmative support from DLNR and the State of Hawaii. At this meeting JDI informed you of its inclination to terminate the Development Agreement because of those issues absent an affirmative undertaking by DLNR and/or the State of Hawaii to assist in achieving a mutually acceptable resolution. You requested that JDI defer making a final decision on whether or not to terminate the Development Agreement in order to allow you additional time to investigate the situation and determine if any assistance from DLNR and/or the State would be forthcoming on these matters.

Given the consistently negative responses provided by DLNR, JDI has concluded that it has no alternative but to advise DLNR that pursuant to the provisions contained in Paragraph 12(a) and 12(c), JDI does hereby terminate the Development Agreement effective as of July 1, 2008, as JDI has determined that it would be impractical, uneconomical and otherwise unfeasible for JDI to proceed with the development of the DLNR Lands as contemplated under the Development Agreement and the original Request For Proposal issued by DLNR (the "**DLNR RFP**").

Your April 21 Letter, May 16 Letter and June 12 Letter also referenced a Notice of Default and the failure to pay allegedly delinquent development fee payments in the amount of \$51,100.00. JDI has considered your request for such payment and respectfully disagrees with DLNR's position that such development fee payments are due and payable as a result of the (a) the delay in the final decision to terminate the Development Agreement was made at the request of DLNR and based on the reasonable (but ultimately false) assumption that after further review DLNR would provide at least some if not all of the requested support, and (b) the breach by DLNR of its good faith and fair dealing obligations under the Development Agreement.

First, when JDI responded to the DLNR RFP for the development of the Kealakehe Lands held by DLNR the County of Hawaii zoning included a resort designation for a portion of the Kealakehe Lands which was consistent with the DLNR RFP requirements that the development proposal provide for a marina based resort (non-residential) development. JDI submitted its response to the DLNR RFP setting forth a proposal for a mixed use marina based resort, containing a new 45 acre marina with 800 boat slips, and authorization for 87 acres of resort development in 7 different resort development pods spread throughout the Kealakehe Lands, as shown on the conceptual development plan submitted with the JDI response. This development concept was incorporated into the approved Development Agreement and JDI has spent a substantial sum of money to develop a proposed master development plan based on those assumptions. In particular it is important to note that DLNR made the development of a 45-acre marina basin with 800 boat slips a mandatory and essential part of any development scheme for the DLNR Lands at Kealakehe.



Ms. Laura H. Thielen, Chairperson  
Department of Land and Natural Resources, Land Division  
June 27, 2008  
Page 3

Second, a basic underlying assumption of the Development Agreement was that DLNR and/or the State which had tendered the DLNR RFP and who would benefit from the leasehold development of the subject Kealakehe Lands owed a good faith duty and obligation to reasonably cooperate with and assist JDI in achieving the various permits and approvals necessary to actually implement the development scheme contemplated under the approved RFP submittal. However, JDI's actual experience with DLNR has been to the contrary. The County of Hawaii has removed the resort zoning for the subject property putting into question the timeshare and hotel developments contemplated within the Resort pods without objection from DLNR or the State. The State has recently reconfirmed that it will take no action with the County and/or under the paramount authority of the State to assure that the County of Hawaii zoning will allow development of the subject Kealakehe Lands in accord with the approved DLNR RFP and the Development Agreement. The planned development of the new marina which was a cornerstone of the DLNR RFP and the DLNR approval of the Development Agreement in the first instance has encountered serious roadblocks and opposition from the Department of Boating and Ocean Recreation (DOBOR), a division within DLNR, as well as the National Parks Service, and the Army Corps of Engineers. The State's response has been that it cannot and will not control DOBOR's comments or objections to the marina, and it will not assist JDI in dealings with either the National Park Service or Army Corps of Engineers. Rather it is up to JDI to work out and resolve all of these issues independently, on its own, and at its sole cost and expense, without the assistance or affirmative support of DLNR or the State, notwithstanding that the lands involved are State lands and that the contemplated development upon the lands is purportedly desired by DLNR and the State.

If JDI had known before what it knows now regarding the lack of tangible and affirmative support and assistance from DLNR and the State with respect to the development of the subject Kealakehe Lands in accordance with the State's own approved DLNR RFP for a marina based resort development, JDI would not have entered into the Development Agreement, and would have saved itself substantial expense, time commitments of its employees and retained consultants, and the personal frustration and disappointment of its principal officers.

Finally when JDI met with you in mid December 2007 JDI informed you of its then current inclination to terminate the Development Agreement for the reasons enumerated and the apparent unwillingness of DLNR and/or the State to cooperate or assist in trying to resolve these major issues in a constructive and supportive manner which would allow the development to proceed along the general lines envisioned by the accepted DLNR RFP. It was at your urging to be allowed additional time to review this matter that JDI did not terminate the Development Agreement at that time. Ultimately the response received from you in the April 21 Letter, May 16 Letter and June 12 Letter did not reflect any real change in position and in JDI's view it is patently unfair for DLNR to also seek to charge additional development fees over this period under these circumstances.

Ms. Laura H. Thielen, Chairperson  
Department of Land and Natural Resources, Land Division  
June 27, 2008  
Page 4

JDI is disappointed that this ambitious, but complex project, involving a public/private sector joint development was not able to be completed, but JDI remains committed to pursuing these types of projects in the future where they make rational and economic sense. JDI remains hopeful that some day in the future JDI and DLNR and/or the State of Hawaii may work cooperatively and successfully on such a project.

If you have any questions regarding the above, please do not hesitate to contact me at (808) 529-7323.

Very truly yours,

McCorriston Miller Mukai MacKinnon LLP



Robert G. Klein

cc: Scott Condra  
David Tarnas  
D. Scott MacKinnon, Esq.  
Russell Tsuji  
Randall Ishikawa, Esq.

LINDA LINGLE  
GOVERNOR OF HAWAII

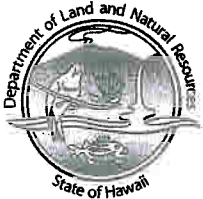


LAURA H. THIELEN  
CHAIRPERSON  
BOARD OF LAND AND NATURAL RESOURCES  
COMMISSION ON WATER RESOURCE MANAGEMENT

RUSSELL Y. TSUJI  
FIRST DEPUTY

KEN C. KAWAHARA  
DEPUTY DIRECTOR - WATER

AQUATIC RESOURCES  
BOATING AND OCEAN RECREATION  
BUREAU OF CONVEYANCES  
COMMISSION ON WATER RESOURCE MANAGEMENT  
CONSERVATION AND COASTAL LANDS  
CONSERVATION AND RESOURCES ENFORCEMENT  
ENGINEERING  
FORESTRY AND WILDLIFE  
HISTORIC PRESERVATION  
KAHOOLAWE ISLAND RESERVE COMMISSION  
LAND  
STATE PARKS



**STATE OF HAWAII  
DEPARTMENT OF LAND AND NATURAL RESOURCES**

POST OFFICE BOX 621  
HONOLULU, HAWAII 96809

August 4, 2008

Robert G. Klein, Esq.  
McCorriston Miller Mukai MacKinnon LLP  
Five Waterfront Plaza, 4<sup>th</sup> Floor  
500 Ala Moana Boulevard  
Honolulu, Hawaii 96813-4920

Dear Mr. Klein:

The Department of Land and Natural Resources ("DLNR") has received your letter, dated June 27, 2008. In that letter, Jacoby Development, Inc. ("JDI") exercises its option to terminate the Development Agreement pursuant to Sections 12(a) and 12(c) of the Agreement. Please note that the Development Agreement provides that JDI shall not be entitled to any compensation or other payment whatsoever by the State on account of such termination, and that all development rights related to the Agreement shall vest with and become the property of the State. See Sections 12 and 26 of the Development Agreement.

The DLNR respects JDI's decision to terminate the Development Agreement and will notify the Board of Land and Natural Resources ("BLNR"). However, JDI should be advised that DLNR does not agree with the allegations made against it in the June 27, 2008 letter. Before addressing the specific allegations in the June 27, 2008 letter, please note the following facts regarding the Development Agreement, and JDI's proposed development of the Kona Kai Ola project ("Project") on the subject property ("Property" or "DLNR lands").

**Development Agreement**

The first thing that JDI was required to do under the Development Agreement was to develop a master development plan, a core infrastructure plan, and master covenants, conditions, and restrictions ("master plans") for the development of the Project on the Property, and to propose and seek the Board of Land and Natural Resources' ("BLNR") preliminary approval of those master plans. The Development Agreement terminates if JDI fails to obtain the BLNR's preliminary approval of the master plans. See Sections 2.2 and 19 of the Development Agreement. JDI never finished development of the master plans and never obtained the BLNR's preliminary approval of any of the master plans. In fact, JDI failed to provide revised master plans for presentation to the BLNR within the time required under Sections 2.2, 3.2, and 4.2 of the Development Agreement, despite being given an extension of more than five months to provide such revised plans.

**EXHIBIT C**

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The Development Agreement provides that after any preliminary approval of the master plans, JDI was to expeditiously and diligently seek to obtain all land use (including environmental impact statements), general plan amendment, zoning, special management area, and other approvals, permits, and entitlements from the United States of America (including the Army Corps of Engineers), State of Hawaii, and County of Hawaii, that were required to develop the Property and Basic Marina Facilities in accordance with the master plans. See Section 9 of the Development Agreement.

The Development Agreement contemplated that it might be difficult if not impossible for JDI to obtain all the government approvals, permits, and entitlements required for the proposed development. That is why it provided for early termination of the Development Agreement if JDI was not able to get all of the required approvals, permits and entitlements or if JDI found it too onerous to do so. See Sections 12(a), 12(c), 19(d), and 19(e) of the Development Agreement.

The State provided no assurances or warranties that JDI would be able to obtain all government approvals, permits, and entitlements required to develop the Property and Basic Marina Facilities. Section 1.1 of the Development Agreement states that the State's selection of JDI as the Developer shall not be deemed a warranty or representation that JDI would be able to obtain all necessary federal, state, or county entitlements, permits, or other approvals required to develop the Property. Similarly, Section 2.3 of the Development Agreement notes that the State's approval of JDI's Master Development Plan shall not be deemed a warranty or representation that JDI would be able to obtain all necessary federal, state, or county entitlements, permits, or other approvals required to develop the Property in accordance with the Master Development Plan.

With respect to government permits, approvals, or authorizations, the Development Agreement provides that the State shall, at JDI's sole cost and expense, reasonably and in good faith cooperate with and assist JDI, as JDI deems necessary and appropriate, "in the filing, processing, and obtaining of any and all permits, approvals, or authorizations" required to be obtained from any governmental agency of the United States, State, or County of Hawaii in connection with the necessary entitlements, further subdivision, and development of the Project, including joinder in any applications or petitions required for such purposes. See Section 7.2 of the Development Agreement. As discussed in this letter, even though JDI never obtained the BLNR's preliminary approval of the master plans, DLNR provided support for proposals to amend the County of Hawaii's General Plan that would clarify JDI's ability to develop the Project. Aside from this proposal, JDI never reached the point of filing, processing, or obtaining any permits, approvals, or authorizations from federal, state, or county agencies.

The Development Agreement contains very specific provisions for the BLNR's approval of the master plans, particularly with respect to environmental impact statements ("EIS"). Section 2.1 of the Development Agreement notes that in order for the Project to proceed, both JDI and the State (BLNR) "must agree on and be satisfied with the master development plan for the Property." Section 2.3 of the Development Agreement requires JDI to prepare and process all required EIS regarding the Project, and that the BLNR would not give final approval to JDI's Master Development Plan until JDI had "received final non-appealable acceptances of all required final EIS covering the entire Project, including the Basic Marina Facilities, and until

after all such final EIS are presented at a public meeting of the Board of Land and Natural Resources.” It was expressly understood and agreed that the BLNR had the right to withhold approval of JDI’s Master Development Plan and to terminate the Development Agreement if, based on the final EIS or matters raised in connection therewith, the BLNR decides that “proceeding with the Project is not acceptable or desirable.” The Development Agreement provided that in making this decision, the BLNR has the right to “consider fully all the environmental factors involved in the Project and to weigh the benefits against the adverse impacts of the Project ....”

### **DLNR Response to Allegations in June 27, 2008 Letter**

#### **1. DLNR honored its obligations and commitments under the Development Agreement**

Contrary to the allegations in the June 27, 2008 letter, DLNR honored its obligations and commitments under the Development Agreement. Under the first phase of the Development Agreement, the DLNR was to review and provide comments and objections regarding JDI’s proposed master plans for the Project. DLNR has provided such comments and objections. JDI is the one who has failed to provide revised master plans and responses to DLNR’s comments and objections within the time required under the Development Agreement.

Your letter claims that DLNR has not provided assurances of assistance in addressing and resolving certain major issues with the Army Corps of Engineers, County of Hawaii, and Division of Boating and Ocean Recreation (“DOBOR”) relating to zoning, permits, and approvals necessary for the contemplated development and marina improvements. The Development Agreement does not require such assurances. What the Development Agreement requires is that the State reasonably and in good faith cooperate with and assist JDI in the “filing, processing, and obtaining of any and all permits, approvals or authorizations” required by any governmental agency in connection with the necessary entitlements, further subdivision, and development of the Project. As discussed below, the DLNR provided such cooperation and assistance.

#### **2. DLNR provided reasonable cooperation and assistance to JDI**

Contrary to the allegations in the June 27, 2008 letter, DLNR has provided reasonable and good faith cooperation and assistance to JDI with respect to the Army Corps of Engineers, County of Hawaii, and DOBOR.

##### **A. Army Corps of Engineers**

At the December 13, 2007 meeting, Mr. Scott Condra of JDI was primarily, if not exclusively, concerned with the prospect that a federal EIS might be required in order to develop the Property. Mr. Condra said that it was hard to see the Project going forward if JDI had to process a federal EIS.



The State has no power to determine whether or not a federal EIS will be required for the development of a project even if that development is on State lands. That determination is solely within the discretion and jurisdiction of the applicable federal agencies, subject to federal court review.

JDI represented to the State that it is an experienced developer, able to deal with local governments and environmental matters, with environmental staff in-house. JDI has been represented by lawyers and consultants, including those with expertise in marine improvements and environmental matters. The Request for Quotations/Request for Proposals that resulted in the Development Agreement ("RFQ/RFP") and the Development Agreement itself required JDI to conduct its own due diligence and to prepare and process all necessary environmental impact statements. Thus, JDI should have investigated and assessed federal EIS issues before or shortly after entry into the Development Agreement, should have been in a better position than the State to assess and handle federal EIS issues that arose in connection with the proposed development, and should have handled such federal EIS issues.

Notwithstanding the foregoing, at JDI's request, DLNR staff met with current and former Army Corps of Engineers staff regarding this matter. In particular, DLNR staff met with Mr. Farley Watanabe of the Army Corps of Engineers to discuss whether a federal EIS would be required for all or any part of the Project. As reported to JDI, Mr. Watanabe was quite adamant that a federal EIS would be required for JDI's proposed development of the proposed marina and at least that part of the Project that was to be on the DLNR lands.

Based on the meeting with Mr. Watanabe and given his authority over the federal EIS issues in question, DLNR staff determined that further discussions with Mr. Watanabe or other federal agencies would be futile. DLNR made a reasonable and good faith effort to assist JDI in this respect.

B. County of Hawaii

The County of Hawaii's General Plan designates the Property as "Urban Expansion." At least one of JDI's consultants has told DLNR staff that JDI could take the position that the Project could be developed under that designation.

While the June 27, 2008 letter appears to claim that the State has "paramount authority" to assure that County of Hawaii zoning will allow the proposed development, DLNR's ability to affect the County of Hawaii's General Plan and zoning decisions is limited. Under section 171-41, Hawaii Revised Statutes ("HRS"), leases for commercial and business uses shall be made only pursuant to a development plan which provides for careful placement of enterprises "consistent with county zoning requirements ..." Thus, the State cannot simply order the County of Hawaii to change its General Plan or zoning to allow JDI's proposed development.

JDI was aware from the start that it would be responsible for investigating County of Hawaii entitlement issues and complying with County standards and requirements. The RFQ/RFP that resulted in the Development Agreement indicates that the contemplated project "currently possesses few, if any of the necessary land use entitlements" and that:

DLNR makes no representations regarding the condition of the subject property or the suitability of the site for any development proposed by any interested developer. The developer shall, at its cost, be responsible for conducting its own investigations and due diligence regarding the subject property.

The RFQ/RFP also provides that the developer selected shall, at its sole expense, obtain all necessary land use entitlements and government permits and approvals, and that the development and construction of the project shall be "in accordance with applicable State of Hawaii and County of Hawaii standards and requirements."

DLNR understands that JDI representatives were working with the County of Hawaii on issues raised by the County's General Plan before the Development Agreement was signed. As noted above, in addition to being an experienced developer, JDI had its own lawyers and professional consultants and was presumably fully advised on this matter.

Finally, even before the Development Agreement was signed, DLNR requested the County of Hawaii to change proposed revisions to its General Plan to allow development of the land around the Honokohau Small Boat Harbor and advised the Mayor and other County officials about the issuance of a request for proposal and later selection of JDI to develop the Property. Following entry into the Development Agreement, the DLNR submitted written testimony on at least seven separate occasions to the County in support of amendments to the General Plan that would facilitate JDI's development of the Property. Further, DLNR staff attended County meetings to testify in support of these amendments and to answer questions. Given the fact that the BLNR never preliminarily approved JDI's master plans for the Project, DLNR staff provided reasonable and good faith cooperation and assistance with respect to JDI's efforts with the County.

C. Division of Boating and Ocean Recreation

DOBOR voiced questions and concerns about JDI's proposed plans for the development of the marina, Basic Marina Facilities, and related areas of the Project. It was entirely appropriate for DOBOR to voice these questions and concerns, and the Development Agreement does not require DOBOR to be "silenced" in order to avoid a breach of that Agreement. As noted previously in this letter, the BLNR has to be "satisfied" with JDI's master plans for the Project and was very concerned with the environmental effects of the proposed development. In order for the BLNR to make a fully informed and prudent decision as to whether or not to approve JDI's proposed master plans, DOBOR had a duty to raise questions and concerns that might impact that decision.

The questions and concerns that DOBOR raised were not unreasonable. Some of the issues that DOBOR raised were: (1) whether increased traffic congestion resulting from JDI's proposed marina created unsafe conditions in the existing entrance channel to Honokohau Small Boat Harbor; (2) whether the alternative of widening the existing entrance channel had been adequately investigated by JDI and its consultants; (3) who would implement and pay for the various traffic congestion mitigation measures proposed by JDI, including relocation of the existing harbor master office; (4) whether DOBOR could relocate and reconfigure its fuel dock to handle the additional traffic from JDI's proposed marina; and (5) other issues regarding the sufficiency of the Basic Marina Facilities proposed by JDI.

By December 2007, based on discussions with DLNR staff and JDI representatives, DOBOR was able to satisfy most of its questions and concerns. The main remaining concerns were safety issues related to the capacity of the existing entrance channel that DOBOR felt it could defer to the Army Corps of Engineers and U.S. Coast Guard. Thus, JDI's complaints with respect to DOBOR are unwarranted as well as invalid.

3. DLNR did not prevent JDI from responding to DLNR's comments and objections to the MMDP, MCIP, and MMCC&R

Some of the DLNR's comments and objections to JDI's proposed Modified Master Development Plan ("MMDP"), Modified Core Infrastructure Plan ("MCIP"), and Modified Master Covenants, Conditions and Restrictions ("MMCC&R") sought information required by the Development Agreement such as a clear identification of how many Development Parcels were proposed, what their sizes were, the applicable zoning classification for each, and in which phase they would be developed. Nothing that the DLNR did or failed to do prevented JDI from providing revised plans or information that responded to these comments and objections.

Some of the DLNR's comments and objections sought information necessary to determine whether the proposed master plans met certain criteria or requirements of the Development Agreement. For example, Section 2.2 of the Development Agreement provides that the BLNR may object to any master development plan that does not provide for: (1) approximately 50% of the Basic Marina Facilities to be constructed in the first phase of the Project; (2) the portion of the Basic Marina Facilities to be constructed during the first phase of the Project to be substantially completed prior to commencement of the second phase of the Project; and (3) for the construction of the remaining Basic Marina Facilities to be substantially complete by a specific date in the second phase of the Project. In its comments and objections, DLNR asked for information necessary to determine whether JDI's proposed plans were objectionable under the foregoing criteria. Nothing that the DLNR did or failed to do prevented JDI from providing the requested information.

Other DLNR comments and objections sought plans or information that the BLNR might need or want in order to decide whether or not to approve JDI's master plans. For example, DLNR asked: (1) what conventional air conditioning facilities would be provided if the SWAC system proposed by JDI could not be used; (2) who would finance and construct certain community benefit facilities such as the Marine Science Center, Yacht Club, Big Game Fishing Club, and Hawaiian Cultural Center, and whether such facilities would be open to the public; (3) when alternative water sources for the Project would be identified and construction of off-site



water improvements completed; (4) whether the existing WWTP could handle the needs of the Project and what expansions or improvements, if any, would be made; and (5) for clarification of various aspects of JDI's proposed phasing plan, development timeline, and financial projections. Nothing that the DLNR did or failed to do prevented JDI from providing the requested plans or information.

4. JDI's entry into the Development Agreement

DLNR denies the allegation that JDI would not have entered into the Development Agreement if it "had known before what it knows now regarding the lack of tangible and affirmative support and assistance from DLNR and the State" with respect to development of the Property.

First, as described above, DLNR has provided tangible and affirmative support and assistance to JDI.

Second, JDI has represented that it is an experienced developer and, during the negotiation of the Development Agreement, JDI was represented by experienced lawyers and consultants, including those who have expertise in obtaining permits, approvals and entitlements with federal, state and county governments. Thus, it is difficult to believe that JDI entered into the Development Agreement based on an unexpressed "assumption" that the State would obtain the required government permits, approvals, and entitlements for JDI's proposed development. This is particularly so since both the RFQ/RFP and the Development Agreement made it clear that: (a) the State was giving no warranties or representations that JDI would be able to obtain all governmental permits, approvals, and entitlements necessary for the proposed development; and (b) JDI, as the developer, would have the responsibility of obtaining all such governmental permits, approvals and entitlements.

5. JDI's past-due development fees

With respect to the allegation that JDI does not owe the past-due development fees because the DLNR Chair requested JDI to delay a decision to terminate the Development Agreement, DLNR staff do not recall any such request being made during the December 13, 2007 meeting. During the meeting, Mr. Condra advised the DLNR Chair that JDI had concerns and reservations about going forward. He did not say that JDI had decided to terminate the Development Agreement. What the DLNR Chair said in response was that she was new to the issues being raised by JDI and would have to review them. Later, JDI requested that the Development Agreement be suspended for an unspecified period of time. The DLNR Chair told JDI that it was not possible to let JDI tie up the Property indefinitely, particularly since JDI also wanted to suspend payment of the required development fees.

As to the allegation that development fees are not due because DLNR breached good faith and fair dealing obligations, DLNR denies that allegation. As shown above, DLNR has provided reasonable and good faith assistance to JDI. DLNR has done nothing to deprive JDI of the benefits of the Development Agreement.

Robert G. Klein, Esq.  
August 4, 2008  
Page 8

In conclusion, DLNR respects JDI's termination of the Development Agreement but denies the allegations made against DLNR in the June 27, 2008 letter. Please note that this letter is not intended to respond to each and every allegation made in the June 27, 2008 letter, and does not waive any rights or defenses of the State all of which are reserved.

Very Truly Yours,



Laura H. Thielen

cc: Mr. Chad A. Martin  
Martin, Mantel & Bignon LLC  
4028 Downeast Lane  
Windemere, Florida 34786

Mr. James F. Jacoby, Chairman  
Scott Condra, Senior Vice-President  
Jacoby Development, Inc.  
171 17<sup>th</sup> Street, NW, Suite 1550  
Atlanta, Georgia 30363

## KONA KAI OLA DEVELOPMENT AGREEMENT - SECTION 12

### "12. Termination of Development Agreement by Developer.

Developer shall have the right at any time prior to the date occurring thirty-two (32) months after the date of preliminary approval of Developer's master development plan by the State (subject to extension in accordance with Section 11 and/or Section 24 hereof), exercisable at its option by giving written notice thereof to the State, to terminate this Agreement, if the contemplated development of the Property in accordance with the Preliminary Master Development Plan or Master Development Plan, as applicable, proves to be impractical, uneconomical or otherwise unfeasible as determined by Developer in its sole discretion, for any of the following reasons:

(a) Inability of Developer to obtain at any time and for any reason (1) the necessary federal, state or county land use, general plan, and zoning approvals to allow for the development of the Property in accordance with the Preliminary Master Development Plan or Master Development Plan, (2) approval of the State to changes proposed to the Preliminary Master Development Plan under Section 2.2 and/or the Core Infrastructure Plan under Section 4.3, or (3) approval for availability of sewer, water, electric and telephone services to the Property;

(b) Determination by Developer based on its environmental assessment and review of the Property that the Property is subject to environmental contamination, remediation and/or clean up issues which are deemed unacceptable to Developer in its sole discretion;

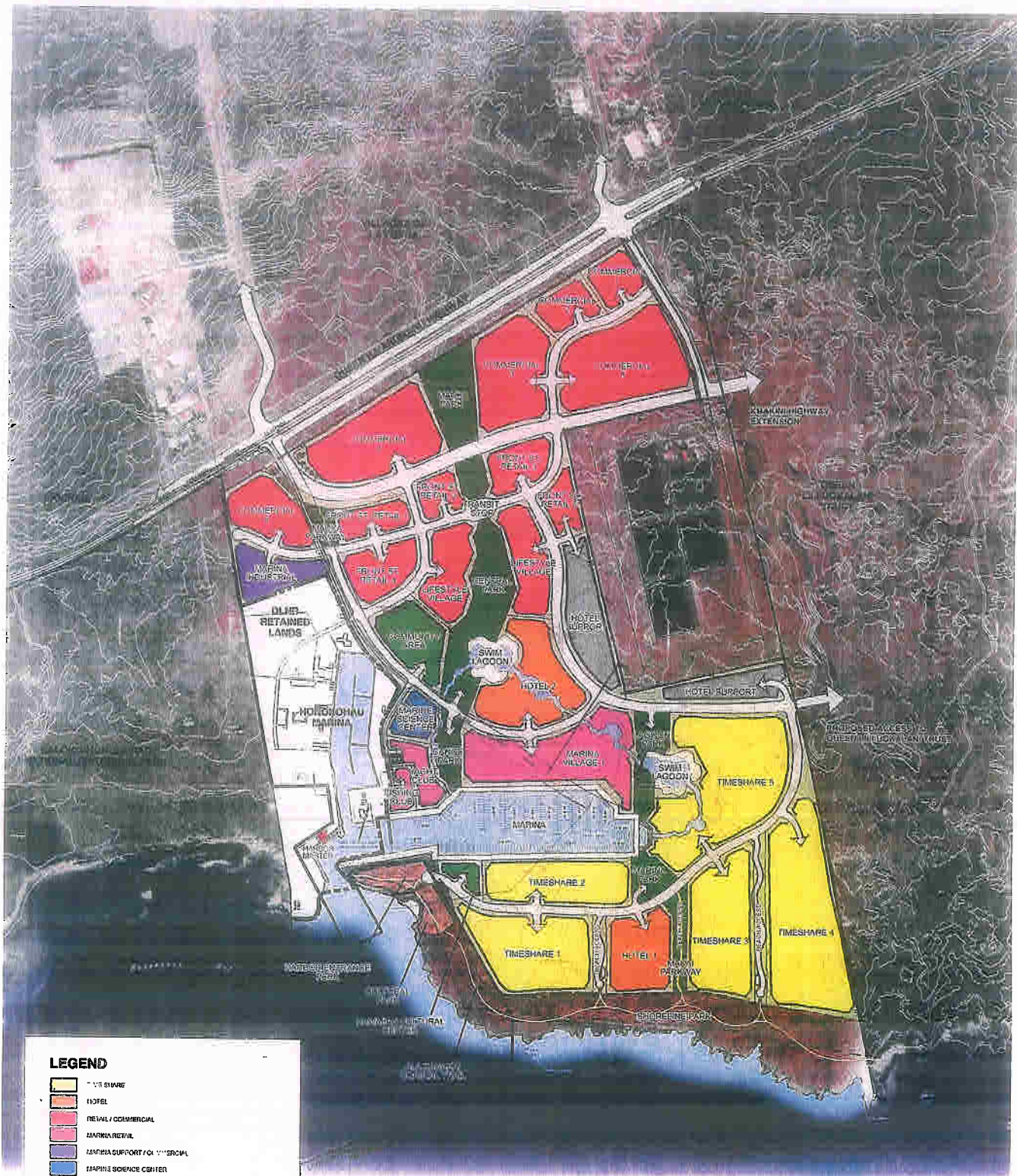
(c) Imposition by the United States of America, the State of Hawaii, and/or County of Hawaii of onerous requirements or conditions on the Developer's receipt of the necessary land use and zoning entitlements, permits or approvals to proceed with the development of the contemplated Kona Kai Ola Project in accordance with the Preliminary Master Development Plan or Master Development Plan, as applicable, which requirements or conditions are unacceptable to Developer in its sole discretion;

(d) Frustration of the contemplated development of the Property in accordance with the Preliminary Master Development Plan or Master Development Plan, as applicable, due to any bona fide action, lawsuit, administrative proceeding, or the like, instituted at any time by any third party; and,

(e) Inability of Developer to obtain financing adequate for the contemplated development of Core Infrastructure upon terms or conditions reasonably satisfactory to the Developer.

If Developer shall exercise its option to terminate this Agreement for any of the reasons above, Developer (i) shall not be entitled to any compensation or other payment whatsoever by the State on account of such termination or for any improvements constructed by Developer on the Property (if any), and (ii) shall deliver to the State, without cost or charge, copies of all plans, specifications, permits and studies prepared for or germane to the Property or part thereof."





# LEGEND

- VAC STAGE
- HOTEL
- RETAIL / COMMERCIAL
- MARINA RETAIL
- MARINA SUPPORT / GOLF COURSE
- MARINE SERVICE CENTER
- COMMUNITY AREA / CULTURAL CENTER
- SWIM LAGOON
- MARINA
- UTILITIES
- PARKS & GREEN SPACE
- DISCRETE
- LANDSCAPE ENTRANCE PARK / CULTURAL PARK



Figure 6 - Modified Master Development Plan

## Kona Kai Ola

JACOBY DEVELOPMENT INC

KEALAKEHE, N. KONA

AREA SCALE

8 Acres

4 Ac 4 Ac

NORTH



LINEAL SCALE (FEET)

400 0 400 800 2000



August 2007

EXHIBIT E